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An Analysis of the Unincorporated Business Income Tax as a Possible Source of Additional Revenue for South Dakota

Wayne A. Schutjer

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AN ANALYSIS OF THE UNINCORPORATED BUSINESS INCOME TAX AS
A POSSIBLE SOURCE OF ADDITIONAL REVENUE
FOR SOUTH DAKOTA

BY
WAYNE A. SCHUTJER

A thesis submitted
in partial fulfillment of the requirements for the
degree Master of Science, Department of
Economics, South Dakota State
College of Agriculture
and Mechanic Arts

March, 1961

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FOR SOUTH DAKOTA

This thesis is approved as a creditable, independent investigation by a candidate for the degree, Master of Science, and acceptable as meeting the thesis requirements for this degree; but without implying that the conclusions reached by the candidate are necessarily the conclusions of the major department.

Thesis Advisor

Head of the Major Department

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This thesis is dedicated to the authors wife, Mable, without whose help and encouragement this thesis could not have been written.

WAS

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CHAPTER I

INTRODUCTION

Reasons for Undertaking the Study

In recent years, the people of South Dakota have demanded a greater number of governmental services as well as an expansion of existing services. These demands have brought about a need for additional revenue, which creates a strong incentive for a state to adopt new taxes. A tax on the income of unincorporated businesses may be a possible source of additional revenue. Therefore, the first reason for undertaking the study is the need of the state of South Dakota for additional revenue.

The second reason for undertaking the study is that an unincorporated business income tax may be needed in South Dakota to maintain equity. The principle of equity demands that all individuals and businesses pay a fair share of the expense of government. If South Dakota, in its search for additional revenue, should adopt a corporation income tax and a personal income tax; an unincorporated business income tax may be needed to maintain equity.

Objectives of the Study

The objectives of the study are: (1) to present the unincorporated business income tax as it is levied in other states and (2) to estimate the annual revenue an unincorporated business income tax would return to South Dakota.

Method and Procedure

The District of Columbia and the states of Connecticut, New York, and Rhode Island were found to levy an unincorporated business income tax. These three states and the District of Columbia were contacted and the structure of the unincorporated business income taxes levied by them was determined. The following were considered to be the most important structural elements: (1) the definition of gross and net income, (2) the definition of unincorporated business, (3) the method of allocation, (4) the rate used, and (5) the system of penalties and appeals.

Income data for unincorporated businesses in South Dakota were then collected. The data were subjected to the definition of unincorporated business and to the rates used by the District of Columbia and the states of Connecticut, New York, and Rhode Island to obtain an estimate of the revenue South Dakota might expect to receive from such an impost.

CHAPTER II

EQUITY IN TAXATION

The purpose of this chapter is to trace the development of the concept of equity in taxation. It is hoped that this history will provide the reader with (1) the information needed to judge the equitability of an unincorporated business income tax and (2) the basis for the author's opinion with regard to the equitability of an unincorporated business income tax.

The problem of equity has two major aspects: (1) the same treatment of persons in like circumstances, and (2) the fair relative treatment of persons in unlike circumstances. Accordingly this chapter will be concerned not only with the historical development of this concept, but also with the various approaches advocated for dealing with the whole problem of equity in taxation.

Today, there are two generally recognized approaches to the problem of equity: (1) the "ability to pay" principle, and (2) the "benefits received" principle.

One of the earliest attempts to deal with this problem was made by Adam Smith in his book, An Inquiry into the Nature and Causes of the Wealth of Nations, which was first published in 1776. In this work, Adam Smith listed four canons of taxation, the first of which dealt with equity. The relevant passage reads as follows:¹

¹ Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, p. 777, The Modern Library: New York, 1937.

The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities: that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation, is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists, what is called the equality or inequality of taxation.

It can be seen that in this first canon Adam Smith hinted at the ability to pay principle as well as the benefits received principle. Smith believed that individuals should contribute to the support of government in proportion to their respective abilities; in other words, he was recommending what is now referred to as the ability to pay principle. Next, he can be seen to suggest the benefits received principle when he wrote that the expense of running a government can be compared with the expense of managing a great estate, and that individuals should contribute to the support of the nation in proportion to their respective interests in the nation in the same fashion that tenants of an estate contribute to the support of the estate.

Ability to Pay Principle

The ability to pay principle requires a system whereby every individual pays to the support of the state according to his ability. It follows that if the burden of government is to be distributed according to this principle, there must be a criterion or criteria established by which the individual's ability to pay can be measured. The three most often mentioned criteria have been (1) income, (2) consumption, and (3) wealth. The last two criteria, consumption and wealth, will not be

considered because this study is concerned with a tax on the income of unincorporated businesses. The first criterion, income, has come to be the most widely accepted index by which ability to pay is measured. The reason for this is that income is generally thought to be the best indicator of economic well-being, although it is not perfect.²

An individual uses income to satisfy the wants and needs of himself and his family. This "want satisfying" power of income is commonly called "utility." If an individual is forced to give up income, he is in effect sacrificing want satisfying power or utility. It was this reasoning that brought about the "sacrifice" theories of taxation.

These theories can be divided into three groups: (1) equal sacrifice, (2) proportional sacrifice, and (3) minimum aggregate sacrifice, all of which will be defined below.

John Stuart Mill in 1848 was the first exponent of the equal sacrifice theory which requires an adjustment of tax rates so the sacrifice created by taxation will be equal for all people. In other words, while individuals might give up different amounts of money, the amount given up would represent the same amount of utility or sacrifice to those individuals.

The proportional sacrifice theory advances the idea that all taxpayers should pay an amount of money which represents the same proportion or percentage of the total utility that they receive from their respective incomes. This means that a person with income which represents twice

²John F. Due, Government Finance, p. 110, Richard D. Irwin, Inc.: Homewood, Illinois, 1959.

as much utility as the income of another would be taxed so as to bear twice as much sacrifice as does the second individual. A tax, levied according to the proportional sacrifice principle, would seek primarily to leave the utility, that individuals received from their income, distributed in the same manner as before the tax was imposed.³

The minimum aggregate sacrifice theory holds that as long as incomes are unequal, the minimum aggregate sacrifice can be reached by taxing only the larger incomes. A tax on a smaller income would hurt its owner more than if the amount were taxed away from an individual with a larger income, since the value of the last dollar received by the person with the lower income is greater than the value of the last dollar received by the individual with the larger income.⁴

It should be noted that this third theory is a corollary of the utilitarian principle that governments should seek the greatest good for the greatest number, or the maximum aggregate welfare.⁵ When applied to taxation, this means the sacrifice of the people as a whole should be kept at the lowest possible level. If, by taxation, the dollars with the least utility are taken away from the people according to their means, the total sacrifice of these individuals collectively will be minimized.

A proponent of the minimum aggregate sacrifice theory is A. C.

³Ibid., p. 114.

⁴Harold M. Groves, Financing Government, p. 20, Henry Holt and Company: New York, 1958.

⁵Ibid., p. 20.

Pigou. He felt that, subject to his qualifications, it was an ultimate principle of taxation.⁶ The levying of taxes was one of the functions of government, and Pigou felt that, apart from the possible effects of the action of one government upon the subjects of other governments, all governmental activity should be regulated with a view to promoting the welfare of its citizens. As Pigou has said, "The day is past in which the welfare of one category of citizens could plausibly be ranked above that of another."⁷ The government would be placing one category of citizens above another, he felt, if it were to tax dollars with high utility from small incomes while there were still low utility dollars in the hands of wealthy people.⁸

One critic of this theory was F. Y. Edgeworth. He argued against the principle declaring that it did not face the situation as it existed in reality, which was that inequalities exist in the income of individuals. He therefore reasoned that, if this theory were put into practice, all fortunes would be equal before there would be "taxation to go round."⁹

Walter J. Blum and Harry Kalvin, Jr. pointed out in their book, The Uneasy Case for Progressive Taxation, that it would be a strange concept of equity which would share the common burden by placing the whole

⁶Exempted from the principle of minimum aggregate sacrifice would be taxes on things which Pigou considered to be evil, for example alcohol.

⁷A. C. Pigou, A Study in Public Finance, p. 59, Macmillan and Co., limited: London, 1928.

⁸Ibid., p. 58.

⁹Francis Edgeworth, "The Pure Theory of Taxation," Classics in the Theory of Public Finance, p. 121, The Macmillan Company: New York, 1958.

load on the wealthier taxpayers.¹⁰

All three sacrifice doctrines assume two premises. The first premise is based upon the law of diminishing marginal utility operating in relation to income; in other words, the marginal utility gained from successive dollars of income declines as income rises. The second premise assumes every person to have an equal capacity for the enjoyment of income.¹¹ This assumption involves interpersonal utility comparisons which is the comparing of relative satisfactions received by different people.

Professor Kendrick questions these basic assumptions. With reference to the first assumption, he admits that there can be so much of any one thing that an additional quantity is desired less, but can there be too much of all things? Money is used not only to purchase individual goods and services, but also for investment. The possession of investments, with their recurring yield of income, provides security, respect, and influence. Professor Kendrick asks if these are subject to the same principle as food and furniture.¹²

Professor Kendrick also takes issue with the second assumption by pointing out that sacrifice is a psychological state of discomfort arising from the giving up of something; it is not a quantity. "The

¹⁰Groves, op. cit., p. 20.

¹¹John F. Due, Government Finance, p. 114, Richard D. Irwin, Inc.: Homewood, Illinois, 1959.

¹²M. Slade Kendrick, Public Finance, p. 493, Houghton Mifflin Company: New York, 1951.

desires that are surrendered are individual to persons holding them, and may differ in kind and degree. But feelings are not measurable. No one can say how much the payment of a tax hurts one person and how much another."¹³ In other words, every one has different subjective values.

Benefits Received Principle

The second of the two general approaches to the problem of equity in taxation is the benefits received principle. This principle involves applying to the governmental sector the commercial rule that goods should be paid for by their users. Accordingly, the philosophy behind this principle calls for all taxes to be adjusted in terms of the benefits received by the individual taxpayer.¹⁴

Two practical questions which arise in applying this principle are often hard to answer. The first of these is that it is not always possible to measure benefits received. Mazzola understood this when he wrote about "the indivisability of benefits." He pointed out that it would be impossible to discover who benefited the most from government services, such as law and order, and public health.¹⁵ The second problem is raised by the question of who receives the greatest benefit from

¹³Ibid., p. 494.

¹⁴John F. Due, Government Finance, p. 107, Richard D. Irwin Inc.: Homewood, Illinois, 1959.

¹⁵Ugo Mazzola, "The Formation of the Prices of Public Goods," Classics In the Theory of Public Finance, p. 42, The Macmillan Company: New York, 1958.

government spending, the rich or the poor. It has been contended that the rich benefit the most as they have more for the government to protect.¹⁶ John Galbraith, however, believes that both the rich and the poor benefit from government spending, but that the poorer citizens are "among the first beneficiaries of the better education, health, housing, and other services..." which result.¹⁷ Thus, the poor may receive more benefit than the rich from government spending.

The benefits received principle, although it is open to some valid criticism, is often used in the application of revenue systems. When governments engage in commercial type activities, they usually collect for their services in full from the beneficiaries. The term "public prices" rather than taxes is usually used for these payments.¹⁸

Perhaps the best known example of the application of the benefits received principle has been the gasoline tax.¹⁹ Most motor vehicles are gasoline powered and are operated on highways. Hence, gasoline consumption has been regarded as a fairly good measure of the benefit an individual obtains from use of the highway system. Another instance where the benefits received principle has been used widely is in determining which unit of government should collect for certain public

¹⁶Groves, op. cit., p. 17.

¹⁷John Galbraith, The Affluent Society, p. 314, Houghton Mifflin Company: Boston, 1958.

¹⁸Groves, op. cit., p. 18.

¹⁹Groves, op. cit., p. 19. Groves points out that business and property taxes rest to some extent upon these principles. They are defended on the ground that government is an important factor of production and an overhead cost of doing business and owning property.

services. Groves points out that the Supreme Court of the United States has shown the importance of the benefits received principle in a case where it held that a governmental unit may not tax individuals who are beyond its jurisdiction.²⁰

The benefits received principle and the ability to pay principle have been studied separately since the time of Adam Smith who ingeniously cut across both of them in his first canon of taxation. Public finance writers of today have expressed the opinion that these are really different routes to the same goal, the goal being the same treatment of persons in like circumstances and a fair relative treatment of persons in unlike circumstances.²¹

John F. Due has expressed the theory that principles of taxation can be selected only in terms of the goals which have been accepted as the appropriate objectives for the economic system by the individuals in the system. He feels that three goals have been regarded as important for maximum economic welfare by present day society: (1) maximum freedom of choice, consistent with the welfare of others; (2) optimum standards of living in terms of the available resources and techniques; and (3) a distribution of income in conformity with the standards of equity currently accepted by society.²² These goals must then become the basis for any equitable present day tax system, according to Due,

²⁰Union Refrigerator Transit Co. V. Kentucky, 199, U.S. 194, 202 (1905).

²¹Due, op. cit., p. 106.

²²Due, op. cit., pp. 103-119.

because equity is what the majority of the people in a society feel is equitable and inequity is what the majority feel is inequitable.

The concept of equity in taxation has gone through many stages of development as has been shown, but perhaps Due is correct when he writes that each generation must decide what is equitable because equity is a subjective concept which depends on the opinions of each generation.

It has been shown above that income is the most widely accepted criterion by which the economic well being of an individual may be judged. This study is concerned with a tax which may be levied on either the net income or the gross income of unincorporated businesses. The advantages, disadvantages, and equitability of both the gross income and the net income methods are pointed up in the summary and conclusions.

CHAPTER III

THE UNINCORPORATED BUSINESS INCOME TAX IN NEW YORK

Brief History

For a long time individuals and groups in New York had recognized the inadequacy of the New York State tax structure and committees had been appointed to work on, and recommend, certain changes in the tax system. As far back as 1919, bills had been introduced that would have amended the tax law by adding a new article which would tax the net income of proprietorships and partnerships. The State Tax Commission had also recommended the inclusion of such a tax in the state laws.²³

The economic conditions of the period preceding 1931, however, were on the whole so favorable that the need for such an impost was not seen by the Legislature.²⁴ The great depression of the thirties radically changed this situation. In 1931 the state of New York had a deficit of twenty-eight million dollars and it should be noted that this was just the first of a series of years with such a deficit.²⁵

Governor Herbert H. Lehman in his executive budget for the fiscal year 1935-1936 recommended the imposition of an emergency tax. The tax was to be imposed at the rate of four percent upon the net income, in excess of five thousand dollars, of every unincorporated business.²⁶

²³Ahmed Mahaud El Morshidy, The Unincorporated Business Tax in the United States With Special Emphasis on New York, (Ph. D. dissertation, Cornell University, 1953), p. 31.

²⁴Ibid.

²⁵Ibid.

²⁶Ibid., p. 32.

A bill was introduced in January of 1935 and was passed in February, which put into law the Governor's recommendation.²⁷ The law has never been repealed, although at the time it was enacted it was thought to be a temporary measure. The unincorporated business income tax is now an integral part of the tax system of the state of New York.

Business Subject to Taxation

Article 23 imposes a tax on the net income of any unincorporated business wholly or partly carried on within the state of New York by either resident or non-resident individuals, partnerships, association, or other entities.²⁸⁻²⁹

The design of the statute is to tax all business income not subject to the corporation franchise tax. The practice of architecture, dentistry, law, and medicine, which under the existing law cannot be conducted under corporate structure, are, however, excluded from the provisions of Article 23. Also excluded from the tax is any profession in which eighty percent of the gross income is derived from the personal services actually rendered by the individual or the members of the partnership and in which capital is not a material income producing factor.³⁰

²⁷Ibid., p. 32.

²⁸Article 16-A was the designation of the New York Unincorporated Business Income Tax Law prior to 1960 when the law was revised and the designation changed to Article 23.

²⁹New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 167, New York, October 1955.

³⁰New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 245, New York, October 1955.

In general a profession includes any occupation or vocation in which:³¹

... a professed knowledge of some department of science or learning is used by its practical application to the affairs of others, either advising, guiding or teaching them, and in serving their interests or welfare in the practice of an act founded on it.

There have been many court decisions concerned with the question of what constitutes a profession. It has been ruled that insurance agents and stock brokers are not considered as practicing a profession.³²⁻³³ A landscape artist using no capital in his business except for office rent, salaries, and equipment, but a pioneer in a field in which a number of universities have formal courses of study leading to degrees, was found to be engaged in a profession.³⁴

The Tax Commission currently recognizes only the following as professions: (a) accounting, (b) certified shorthand reporting, (c) chiropody, (d) dental hygiene, (e) engineering, (f) optometry, (g) osteopathy, (h) pharmacy, (i) physiotherapy, (j) surgery, (k) teaching, and (l) veterinary medicine.³⁵

Gross Income

Gross income, for the purpose of the unincorporated business

³¹Ibid.

³²Recht V. Graves, (1939) 257 A. D. 889, 12. N.Y.S. 2 d 158.

³³Hendrich V. District of Columbia, (1950) 183 F. 2 d, 1002.

³⁴Geiffert V. Mealey, (1944) 293 N. Y. 583, 59 N.E. 414.

³⁵Ibid.

income tax, is defined by the state of New York as:³⁶

...the sum of the items of income and gain of the business, of whatever kind and in whatever form paid, includible in gross income for the taxable year for federal income tax purposes, including income and gain from any property employed in the business or from liquidation of the business or from collection of installment obligations of the business, with the modifications specified in this section.

The modifications can be divided into two groups: (1) those which increase federal gross income and (2) those which decrease it. The former group of modifications includes two types of income: (a) income from interest on the obligations of any state other than New York and, (b) income from interest on obligations which are exempt from the federal income tax but not from the state income tax.³⁷

There are six modifications which decrease federal gross income in the New York law. They consist of the deduction of the following six types of income:³⁸

- (1) income from the interest on obligations of the United States, which is included in gross income for federal income tax purposes;
- (2) interest or dividend income on obligations which are exempt from state income taxes, including the unincorporated business income tax, under the laws of New York;
- (3) interest or dividend income on obligations which are exempt

³⁶State of New York, Laws of New York, Chapter 564, Article 23, p. 3, April 1960.

³⁷Ibid.

³⁸State of New York, Laws of New York, Chapter 564, Article 23, pp. 3-4, April 1960.

- from state income taxes by federal law;
- (4) any income which is taxed under the corporation income tax levied by New York;
 - (5) the amount of any refund or credit made by New York for overpayment of New York income taxes; and
 - (6) any increase in income from the sale of property which had a higher adjusted basis for New York unincorporated business income tax purposes than for federal income tax purposes on the last day of the last taxable year for which article 16-A imposes a tax, which does not exceed such difference in basis.³⁹

The first five modifications are self explanatory. The sixth modification, however, needs some additional explanation. Both the federal government and the state of New York tax the amount received, in excess of the depreciated value, from the sale of property. If the federal government's method of calculating the value of the property, for income tax purposes, results in a lower valuation than does the method used by New York, the taxpayer may deduct from his federal gross income the difference between the two valuations in the computation of his gross income for the purposes of the New York unincorporated business income tax.

Net Income

Net income is computed by subtracting the allowable deductions

³⁹Article 16-A was the designation of the New York Unincorporated Business Income Tax Law prior to 1960 when the law was revised and the designation changed to Article 23.

from gross income. Unincorporated business deductions are defined by the state of New York as items of loss and deduction directly connected with or incurred in the conduct of business which are allowable for federal income tax purposes.⁴⁰ The New York law, however, modifies five of the federal income tax deductions. The modifications are as follows:

- (1) Whereas the federal income tax law allows no deduction for charitable contributions, the New York law allows this deduction, but not in excess of five percent of the amount by which the unincorporated business gross income exceeds the business deductions, computed without the benefit of any deduction for charitable contributions.⁴¹
- (2) The federal income tax allows the deduction of state income taxes while the New York law allows no deduction for income taxes imposed by New York or any other taxing jurisdiction.
- (3) The New York law does not provide for a deduction of interest on debts incurred to purchase securities if the income of the securities is exempt from the New York unincorporated business income tax.
- (4) The federal income tax allows the deduction of net short term capital losses from net long term capital gains and allows the deduction of fifty percent of the excess from gross income

⁴⁰State of New York, Laws of New York, Chapter 664, Article 23, p. 4, April, 1960.

⁴¹Prentice-Hall, 1961 Federal Tax Course, "Students Edition," p. 2413, Prentice-Hall Inc.: Englewood Cliff, N.J., 1961.

when computing net income. The New York law taxes all long term capital gains as ordinary income and treats capital losses as ordinary business losses which may be deducted in full when computing net income.⁴²

- (5) No deduction is allowed, under the New York law, for amounts paid or incurred to a proprietor or partner for services or for the use of capital but an allowance for proprietor's salary, which may not exceed twenty percent of net income or five thousand dollars per owner, whichever is least, is allowed.⁴³

Tax on Business Partly Conducted in New York

When the income of an unincorporated business is from sources within the state there is no problem as to what part of the income the state may tax, since it has the power to tax the entire amount. The problem of what part of the income of the business a state may tax arises, however, when income is derived both within and without the state.

The two most widely accepted methods of determining how much of a businesses income may be allocated to the taxing state are separate accounting and the formula method:⁴⁴

⁴²Ibid., p. 2411.

⁴³State of New York, Laws of New York, Chapter 564, Article 23, p. 5, April, 1960.

⁴⁴William F. Railing, History and Development of Corporation Net Income Taxation in the State of New York, (Ph.D. Dissertation, Cornell University, 1958), p. 147.

Dr. William F. Railing writes as follows:⁴⁵

As the name implies, the separate accounting method treats the business within the state as though it were separate and distinctive from the business carried on outside the state. An attempt is made to determine the net income from the particular state as if the business were confined to that state. First, the gross income from sources within the particular state is calculated. Second, the expenses attributed to the obtaining of such gross income are separately determined as closely as possible. Third, the expenses attributable to the gross income are deducted from the gross income to arrive at the net income taxable by the particular state.

With respect to the formula method, Dr. Railing has this to say:⁴⁶

When the formula method is used, the net income from the entire business is first determined by deducting the total expenses and other deductible items from the total gross income of the taxpayer. The resulting net income is then apportioned among the various states in which the company conducts its business on the basis which the average of the factors of the formula within each state bears to the average of the total of such factors within and without the state.

The state of New York makes use of both these methods. If the books of the unincorporated business are not kept so as to show the proportion of the business income earned in New York, the taxpayer's return is expected to show the total income and the part apportioned to New York with the basis upon which the apportionment was made. If the basis used is approved by the Tax Commission, the return is accepted; if it is not approved, however, an amended return is required.

The Massachusetts formula is used to determine what percentage of income is derived from sources within the state of New York. The Massachusetts formula makes use of three elements: (1) real and tangible

⁴⁵Ibid., pp. 147-148.

⁴⁶Ibid., p. 149.

personal property, (2) receipts, and (3) payrolls. The percentage of real and tangible personal property located within the state as compared with real and tangible personal property located both within and without New York is calculated. This percentage is added to the percentages calculated by comparing receipts within the state to receipts everywhere and payrolls within the state to payrolls everywhere. The sum of these three percentages is then divided by three to determine the percentage of total income to be allocated to New York.⁴⁷ Thus the allocation percentage is calculated by using the following formula:

The average of the value of real and tangible personal property within the state, at the beginning of the taxable year and at the end of the taxable year.	The total wages, salaries, and other personal service compensation paid during the year to employees in connection with the business carried on within the state.	The gross sales or charges for services performed by or through an agency located within the state.	
_____ X 100 +	_____ X 100 +	_____ X 100	
The average of the value of all the real and tangible personal property at the beginning of the taxable year and at the end of the year, both within and without the state.	The total wages, salaries, and other personal service compensation paid during the taxable year to employees connected with the unincorporated business, whether within or without the state.	The gross sales or charges for services performed both within and without the state.	
<div style="text-align: center;">3</div>			Percentage of income = allocated to New York.

If the above procedure does not allocate a fair and equitable

⁴⁷New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 261, New York, October, 1955.

proportion of the net income of an unincorporated business to the state, the Tax Commission may prescribe any other fair and equitable procedure.⁴⁸

Rate of the Tax

The unincorporated business income tax levied by the state of New York is on net income (after a five thousand dollar deduction) and the rate is the same for all business taxed. The rate of the tax for the calendar years 1935 to 1944, inclusive, and for fiscal years ending 1936 and 1945 was four percent. The rate was three percent for the calendar years 1945 and 1946 and fiscal years ending during the calendar years 1946 and 1947. The present rate of the tax, commencing with the calendar year 1947, is four percent.⁴⁹ This rate, however, did not actually come into operation until the beginning of the calendar year 1954, or the beginning of the fiscal year 1955. During this period, from the calendar year 1947 to 1953 inclusive, and the fiscal years ending in 1948 to 1954 inclusive, a temporary reduction of twenty-five percent was allowed that had the effect of lowering the rate to three percent. This reduced rate also applied for any period of less than one year during the calendar years 1950 to 1954 inclusive.⁵⁰

Revenue

As can be seen in Table I, the unincorporated business income tax

⁴⁸Ibid., p. 256.

⁴⁹New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 238, New York, October, 1955.

⁵⁰Ibid.

levied by the state of New York has been a fairly productive impost, both in terms of dollars yielded as well as in the percentage of total tax revenue. The levy yielded a total of \$61,828,355.00 during the fiscal years 1958 and 1959, which can be seen to represent two percent of the total tax revenue for those years.

TABLE I. REVENUE RETURNED TO NEW YORK BY THE
UNINCORPORATED BUSINESS INCOME TAX

Year	Revenue Received from the Unincor- porated Business Income Tax	Total Tax Revenue From All Sources	Revenue from the Unincorporated Business Income Tax as a Percent- age of Total Tax Revenue from all Sources
1958	\$ 31,071,147	\$ 1,501,397,000	2.07
1959	30,757,208	1,586,066,000	1.94
Total	\$ 61,838,355	\$ 3,087,463,000	2.00

Source: U. S. Department of Commerce, Compendium of State Government Finances in 1958, Table five, p. 11.

U. S. Department of Commerce, Compendium of State Government Finances in 1959, Table five, p. 11.

Payment of the Tax and Penalties

The unincorporated business tax levied by the state of New York is due on the fifteenth day of the fourth month following the close of the taxable year.⁵¹ If the taxable year is the same as the calendar

⁵¹New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 257, New York, October, 1955.

year, the tax falls due on April fifteenth.⁵² A taxpayer should render his tax return, in as complete and final form as possible, on or before the date it is due. The Tax Commission is, however, authorized, when good cause exists, to grant an extension of time in which the return may be filed. An extension is usually only granted when, in the judgment of the Tax Commission, further time is actually required for the taxpayer to make an accurate return. Except in cases of taxpayers who are abroad or in the military service, no extension may exceed six months.⁵³

A taxpayer who does not file a return or remit his tax by the date it is due, but does so within sixty days after the due date, will be liable to pay, as a penalty, five percent of the tax. Should a taxpayer neither file a return nor pay his tax within sixty days after the due date, he will be penalized an amount equal to the original tax. In both these instances of delinquency, a taxpayer would also be liable for an additional one percent of the tax for each month or fraction of a month during which the tax remained unpaid. Where the original tax is less than two dollars, two dollars is added to the original tax and the one percent per month is levied on that sum.⁵⁴

Should a taxpayer file an incorrect return which understates the tax, due to negligence on the part of the taxpayer, but without intent to defraud, a penalty of five percent of the deficiency is levied. If

⁵²Ibid.

⁵³Ibid., p. 138.

⁵⁴Ibid., p. 140.

the statement of the tax is false with intent to evade the tax, the tax on the additional income discovered to be taxable is doubled. In addition a further one percent of the tax will be collected for each month or fraction of a month from the date due in both these cases.⁵⁵

A further penalty, not to exceed one thousand dollars or one year in jail or both, may be levied against a taxpayer, who with intent to evade any tax or any requirement of the unincorporated business income tax law, fails either to pay the tax, or to make, sign, or verify a return. A similar penalty may be levied against any taxpayer who, with intent to evade, shall make, render, sign, or verify a false or fraudulent return.⁵⁶

Appeals

A taxpayer who feels that he has been unjustly treated with respect to his unincorporated business tax bill may file an application for revision or refund. The application must be filed within two years from the filing of the return, in the form prescribed by the Tax Commission, and must set forward the grounds upon which the application is being made.⁵⁷

If a taxpayer has been notified by mail that his application for revision or refund has been denied, he may request a formal hearing.

⁵⁵Ibid., p. 141.

⁵⁶Ibid.

⁵⁷New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 145, New York, October, 1955.

If a demand for a hearing is filed with the Tax Commission by a taxpayer within ninety days, the hearing will be granted and held at a time and place designated by the Commission. If the demand is not made within the specified time, no hearing will be granted and the case will be considered closed.⁵⁸ Should the taxpayer still be dissatisfied after the hearing, he may apply for a review of the hearing. The application for review must be made within ninety days after the close of the hearing.⁵⁹

⁵⁸Ibid.

⁵⁹Ibid.

CHAPTER IV

THE UNINCORPORATED BUSINESS INCOME TAX IN THE DISTRICT OF COLUMBIA

Brief History

The District of Columbia has levied a tax on the net income of unincorporated businesses since 1947.⁶⁰ The tax has not been amended or altered in any way. It has, however, always been criticised and consideration is presently being given to expanding the law to include certain professions, service businesses, and rentals of real estate.⁶¹

Business Subject to Taxation

The purpose of the unincorporated business tax levied by the District of Columbia is to impose a tax upon all businesses whose income would have been subject to the corporation franchise tax of the District if the firm had been incorporated. According to the statutes of the District, the tax is imposed upon the net income of:⁶²

... any trade or business, conducted or engaged in by any individual, whether resident or non-resident, statutory or commonlaw trust, estate, partnership, or limited or special partnership, society, association, executor, administrator, receiver, trustee, liquidator, conservator, committee, assignee, or by any other entity or fiduciary, other than a trade or business conducted or engaged in by any corporation;...

⁶⁰Personal correspondence with A. F. Krall, Assistant to the Chief of Research and Planning, District of Columbia, Sept. 1, 1959.

⁶¹Ibid.

⁶²District of Columbia, Unincorporated Business Franchise Tax Return Instruction Sheet, Instruction 1, Washington, D.C., 1958.

Exempt from the impost are trades and businesses which by law, custom or ethics cannot be incorporated. The Statutes of the District of Columbia prohibit the incorporation of certain occupations. These occupations include dentistry, dental surgery, podiatry, certified public accounting, registered architecture, and professional engineering.⁶³ Professions recognized as exempt because they cannot by custom or ethics be incorporated are law, medicine, and surgery.⁶⁴

Also exempt from the impost are trades and businesses: (a) in which more than eighty per-cent of the gross income is derived from personal services actually rendered by the owners, and (b) in which capital is not a material income producing factor. Capital is defined for the purposes of the business tax as the total value of all the assets, tangible or intangible, of a business which are essential to and used in conducting the business.⁶⁵

In order to determine if eighty per-cent of the gross income of a business is derived from the personal services of the owners, it is assumed that employees produce gross income at least equal to their wages or salaries. Therefore, the total amount paid employees may not exceed twenty per-cent of gross income if a business hopes to be exempt from the levy. To determine if capital is a material income producing factor, the average total amount of capital employed during the year is compared to

⁶³Ibid., Instruction 4.

⁶⁴District of Columbia, Unincorporated Business Franchise Tax Return Instruction Sheet, Washington, D.C., 1958, Instruction 4.

⁶⁵Ibid.

total charges made to customers during the year. If the average total amount of capital employed does not exceed twenty percent of the total charges to customers during the year, it is assumed that capital was not a material income producing factor.⁶⁶

Gross Income

The District of Columbia defines gross income as:⁶⁷

... gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, including salaries, wages, and compensation paid by the United States to its officers and employees to the extent the same is not exempt under this article, or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this article, growing out of the ownership, or sale of, or interest in, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains of profits, and income derived from any source whatever.

Income derived from the following sources is not included in gross income:⁶⁸

- (1) the proceeds of life insurance policies paid by reason of the death of the insured;
- (2) the value of property acquired by gift, devise, or inheritance (but the income from such property shall be included in gross income);
- (3) income from annuities;
- (4) interest upon (a) the obligations of a state, territory of the

⁶⁶Ibid.

⁶⁷District of Columbia, Income and Franchise Tax Law and Regulations, p. 7, Washington, D.C., 1959.

⁶⁸Ibid.

United States, or any of their political subdivisions, or the District of Columbia; and (b) obligations of the United States, its agencies, or instrumentalities;

- (5) amounts received, through accident or health insurance or under workmen's compensation or employees liability acts, or by way of damages for personal injuries, whether by suit or agreement;
- (6) income exempt under treaty;
- (7) income of foreign governments;
- (8) veterans payments; and
- (9) gains from sale or exchange of any capital asset.

Net Income

Net income is gross income minus the following deductions:⁶⁹

- (1) all ordinary and necessary business expenses;
- (2) all interest paid or accrued within the taxable year;
- (3) all taxes imposed upon the taxpayer and paid or accrued during the taxable year except (a) income taxes, (b) franchise taxes, (c) estate, inheritance, legacy, succession, and gift taxes, (d) local assessments that tend to increase the value of the property assessed, and (e) taxes paid on property, business, or occupations, which produce, income which is not taxable under the franchise tax law;

⁶⁹Ibid., pp. 10-13.

- (4) losses sustained during the taxable year which were not compensated for by insurance or otherwise;
- (5) debts ascertained to be worthless and charged off during the taxable year or a reasonable allowance added to a reserve for bad debts;
- (6) insurance premiums;
- (7) a reasonable allowance for exhaustion and the wear and tear of property used in trade or business, including a reasonable allowance for obsolescence;
- (8) contributions to an employees' trust or annuity plan;
- (9) a reasonable allowance for salaries or other compensation for personal services actually rendered, but the aggregate salary deduction for owners may not exceed twenty percent of net income before this deduction; and
- (10) contributions for gifts paid (contributions may not exceed fifteen percent of adjusted gross income).

In computing net income, no deduction is allowed for the following:⁷⁰

- (1) personal or family expenses;
- (2) amounts paid out for new buildings or for permanent improvements made to increase the value of property;
- (3) amounts spent in restoring property for which a depreciation allowance has been made;

⁷⁰Ibid., p. 13.

- (4) premiums paid on any life insurance policy covering the life of any officer or employee if the business is a beneficiary of the policy; and
- (5) capital losses.

A further exemption of five thousand dollars from net income is allowed to each unincorporated business. Where the period covered by a return is less than a year, the exemption is prorated on a daily basis.⁷¹

Tax on Business Partly Conducted in the District⁷²

If the trade or business of any unincorporated firm is carried on both within and without the District, the net income subject to taxation by the District is determined under regulations prescribed by the Tax Commissioner.⁷³ If income is derived from the sale or manufacture of tangible personal property, a formula involving one factor, sales, is specified by the regulations of the District.⁷⁴ The allocation percentage would then be calculated by using the following formula:

$$\frac{\text{Total sales within the District of Columbia}}{\text{Total sales within and without the District of Columbia.}} \times 100 = \text{Percent of income allocated to the District of Columbia.}$$

⁷¹District of Columbia, Income and Franchise Tax Law and Regulations, p. 22, Washington, D.C., 1959.

⁷²For a discussion of allocation methods see p. 20.

⁷³District of Columbia, Income and Franchise Tax Law and Regulations, p. 26, Washington, D.C., 1959.

⁷⁴Ibid., p. 237.

Where income is derived from work done or service performed, the regulations of the District specifies the use of a formula which has cost as its allocation factor.⁷⁵ The allocation percentage is calculated by using the following formula:

$$\frac{\text{Total cost incurred within the District of Columbia}}{\text{Total cost incurred within and without the District of Columbia.}} \times 100 = \text{Percent of income allocated to the District of Columbia.}$$

When the net income of a taxpayer from within the District may be more accurately determined by use of separate accounting, the tax is assessed on that basis rather than by the formula method.⁷⁶

Rate of the Tax

The unincorporated business franchise tax of the District of Columbia imposes a tax at a flat rate of five percent on the net income of every unincorporated business subject to the impost. The rate is the same for all types of business and no differentiation is made between wholesale and retail.⁷⁷

Revenue

The unincorporated business income tax levied by the District of

⁷⁵Ibid., p. 238.

⁷⁶Ibid., p. 239.

⁷⁷District of Columbia, Income and Franchise Tax Law and Regulations, p. 21, Washington, D.C., 1959.

Columbia has not been very productive either in terms of dollars yielded or as a percent of total tax revenue. As can be seen in the table, the levy yielded a total of \$3,016,476.00 during the fiscal years 1957, and 1958, which was only 1.03 percent of the total tax revenue for those years.

TABLE II. REVENUE RETURNED TO THE DISTRICT OF
COLUMBIA BY THE UNINCORPORATED BUSINESS
INCOME TAX

Year	Revenue Received from the Unincor- porated Business Income Tax	Total Tax Revenue from all Sources	Revenue from the Unincorporated Business Income Tax. As a Percentage of Total Tax Revenue from all Sources
1957	\$ 1,485,121	\$ 143,258,000	1.04
1958	1,531,355	150,011,000	1.02
Total	\$ 3,016,476	\$ 293,269,000	1.03

Source: International City Managers Association, The Municipal Year Book, Chicago, 1960, Table XII, p. 216.

Payment of the Tax and Penalties

The unincorporated business tax may be paid to the Treasurer of the District of Columbia either in full when the return is filed or in two equal installments.⁷⁸ If the taxpayer should choose to pay the tax in installments, he must pay the first one on or before the fifteenth

⁷⁸District of Columbia, Unincorporated Business Franchise Tax Return Instruction Sheet, Instruction 10, Washington, D.C., 1958.

day of the tenth month following the close of the taxable year. Taxable year means either the calendar year or the fiscal year, whichever the taxpayer has adopted.⁷⁹ Having chosen one or the other the taxpayer may not then change from a calendar year to a fiscal year or vice versa within any taxable year without the written permission of the Tax Commissioner.⁸⁰

The penalty for failure to make and file a return on time is five percent of the tax each month it remains unpaid, but this penalty may not exceed twenty-five percent of the aggregate.⁸¹ For failure to pay the tax on time, interest may be imposed upon the unpaid amount at the rate of one half of one percent per month until payment is made.⁸² For wilfully attempting to evade payment of the tax, a penalty of five thousand dollars or imprisonment for not more than one year, or both, may be levied.⁸³

If a deficiency should be discovered in the amount of income reported, which was due to negligence without intent to defraud, five percent of the deficiency in addition to the deficiency may be assessed. If the deficiency was due to fraud with intent to evade the tax, fifty percent of the deficiency in addition to the deficiency may be assessed.⁸⁴

⁷⁹District of Columbia, Income and Franchise Tax Law and Regulations, p. 3, Washington, D.C., 1959.

⁸⁰Ibid.

⁸¹Ibid., p. 44.

⁸²Ibid., p. 45.

⁸³Ibid.

⁸⁴District of Columbia, Income and Franchise Tax Law and Regulations, p. 45, Washington, D.C., 1959.

Appeals

Any taxpayer aggrieved by any assessment may appeal to the Board of Tax Appeals for the District of Columbia.⁸⁵

⁸⁵Ibid... p. 49.

CHAPTER V

THE UNINCORPORATED BUSINESS INCOME TAX IN RHODE ISLAND

Brief History

Seven years after the state of New York levied a tax on the income of unincorporated business, Rhode Island followed suit. The tax levied by Rhode Island is very similar to that levied by the state of Connecticut.⁸⁶

A Special Commission, which was set up to study the financial problems of Rhode Island and its municipalities, proposed an unincorporated business tax in a report dated January, 1942.⁸⁷ The Commission argued that the impost would eliminate one of the inequalities of their present tax structure, namely, that while the incomes of incorporated businesses were taxed, those that were unincorporated escaped paying any impost on their income. They went on to add that this tax was of a more limited scope than the corporation tax and that the base of the proposed tax was gross income derived from the conduct of unincorporated business.⁸⁸

An unincorporated business income tax law was enacted by Rhode Island in the same year in which it was proposed. As originally passed in 1942, the tax differed from the present impost in the following ways:⁸⁹

⁸⁶Ahmend Mahoud El Morshidy, The Unincorporated Business Tax in the United States with Special Emphasis on New York, (Ph. D. dissertation, Cornell University, 1953), p. 34.

⁸⁷Ibid., p. 34.

⁸⁸Ibid., p. 34.

⁸⁹Personal Correspondence with Fred M. Langton, Tax Administrator, p. 2, Rhode Island, May 23, 1960.

(1) the definition of retail mercantile business did not include the business of leasing tangible personal property; (2) the definition of gross receipts was not limited, when a business furnished services and sold tangible personal property, to gross receipts from the selling of tangible personal property; and (3) the tax did not apply unless gross receipts for the year exceeded thirty thousand dollars, in which case the entire gross receipts were taxable.

Business Subject to Taxation

The state of Rhode Island imposes an unincorporated business tax on the gross receipts of retail mercantile business, wholesale mercantile business, motor transportation business, amusement business and manufacturing. The following are the definitions of these types of enterprises:⁹⁰

- (1) Retail mercantile business is "the business of buying tangible personal property and selling the same to consumers for profit or gain, or leasing or renting said property for profit or gain."
- (2) Wholesale mercantile business is "the business of buying tangible personal property and selling the same for the purpose of resale."
- (3) Motor transportation business is "the business of carrying passengers or tangible personal property in or upon motor vehicles."

⁹⁰State of Rhode Island, Division of Taxation, Unincorporated Business Tax Return, Instruction Sheet, Providence, Rhode Island, 1959, Definitions.

- (4) Amusement business is "the operation for profit of any form of amusement enterprise, whether sport, entertainment or recreation, including but not limited to plays, bingos, skating rinks, bowling alleys, theatres, halls, or other inclosure, or any combination of the foregoing events."
- (5) Manufacturing is "the making or changing for profit or gain of articles or materials into suitable forms for use of consumption, or repairing, renovating, or cleaning property for profit or gain. Without excluding from taxation gross receipts received by taxpayers from the conduct of other manufacturing enterprises, those engaged in conducting restaurants, bakeries, laundries, printing and publishing businesses, photographic and other picture production business, carpentry and building, plumbing, electrical, garage, automobile washing, commercial painting and decorating, lumber and fuel production, masonry and bricklaying businesses, ice supply and similar trades, road and sewer construction, and quarrying and mining businesses, shall be construed as engaged in manufacturing."

Without excluding from taxation gross receipts received by any taxpayer from the conduct of other retail and wholesale mercantile enterprises, a taxpayer engaged in conducting a hotel or boarding house, or a floral and plant nursery business, or any similar trade is construed to be engaged in a retail or wholesale mercantile business, with respect to gross receipts which are derived from the sale of tangible personal

property.⁹¹ Dealers in farm products, animals, seafood, fruit, etc., must report and pay a tax on the gross receipts from the sales of property or goods bought and sold, but these dealers need not include receipts from sales of their products which were produced or raised by them. On the other hand, taxpayers engaged in floral or plant nursery business must include gross receipts from sales of their products whether or not the products are produced or raised by them.⁹²

Gross Income

Gross receipts are defined for purposes of the unincorporated business income tax, as follows:⁹³

... all receipts, whether in the form of money, credits or other valuable consideration received during the income year in connection with any taxable unincorporated business except payments received in liquidation of debts representing gross receipts included in any previous return made by the taxpayer or representing gross receipts attributable to an income year the receipts of which are not taxable. However, gross receipts derived from real estate rentals or the sale of intangible property should be excluded from entire gross receipts."

The state of Rhode Island allows a deduction of five thousand dollars from gross receipts. The exemption may be claimed by either a retail or wholesale business, but if a taxpayer has two or more retail or two or more wholesale businesses or a combination of the two, they are

⁹¹Ibid.

⁹²Ibid.

⁹³State of Rhode Island, Division of Taxation, Unincorporated Business Tax Return, Instruction Sheet, Providence, Rhode Island, 1959, Definitions.

considered as one business, and only one exemption of five thousand dollars may be claimed.⁹⁴

Tax on Business Partly Conducted in Rhode Island⁹⁵

If the gross receipts of an unincorporated firm are from business conducted wholly within the state of Rhode Island, the entire gross receipts are taxable. When the trade or business of an unincorporated firm is carried on both within and without the state of Rhode Island, the tax is imposed only upon the gross income from business carried on within the state. The entire gross receipts of domestic manufacturing enterprises are taxable, irrespective of the fact that part of the merchandise may be sold outside the state of Rhode Island. If income is from an enterprise other than manufacturing, separate accounting is the method prescribed to segregate income earned within the state from that earned everywhere. If it is not possible to determine the actual gross receipts attributable to Rhode Island by separate accounting, the Tax Administrator prescribes the use of a formula. The allocation is then made on the basis of their formula which makes use of one or more of the following factors:⁹⁶ (1) purchases, (2) payrolls, (3) value and situs of property, or (4) any other factor or factors which are deemed to be

⁹⁴State of Rhode Island, Division of Taxation, Unincorporated Business Tax Return, Instruction Sheet, Instruction 5, Providence, Rhode Island, 1959.

⁹⁵For a discussion of allocation methods see p. 20.

⁹⁶Personal Correspondence with Fred M. Langton, Tax Administrator, Rhode Island, p. 2, May 23, 1960.

fair and equitable by the Tax Administrator.

Rate of the Tax

The state of Rhode Island taxes retail mercantile, manufacturing, motor transportation and amusement business at a rate different from that with which it taxes wholesale mercantile business. The rate for the first class of unincorporated businesses is two dollars per thousand dollars (.2 percent) of gross receipts in excess of thirty thousand dollars. The rate of wholesale mercantile business is one dollar per thousand dollars of gross receipts (.1 percent) in excess of thirty thousand dollars.⁹⁷

Revenue

The unincorporated business income tax levied by the state of Rhode Island has not been a very productive impost, either in terms of dollars yielded or as a percent of total tax revenue.

As can be seen in Table III, the levy yielded a total of \$2,462,073.00 during the fiscal years 1957, 1958, and 1959. This was only 1.06 percent of the total tax revenue for those years.

⁹⁷ State of Rhode Island, Division of Taxation, Unincorporated Business Tax Return, Instruction Sheet, Providence, Rhode Island, 1959, Rates of Tax.

TABLE III. REVENUE RETURNED TO RHODE ISLAND BY ITS
UNINCORPORATED BUSINESS INCOME TAX

Year	Revenue Received From the Unincor- porated Business Income Tax	Total Tax Revenue From all Sources	Revenue from the Unin- corporated Business Income Tax as a Percent- age of Total Tax Revenue From all Sources
1957	\$ 814,035	\$ 62,563,000	1.3
1958	830,116	69,870,000	1.2
1959	817,922	79,160,000	1.03
Total	\$2,462,073	\$231,593,000	1.06

Source: U.S. Department of Commerce, Compendium of State Government Finances in 1957, table five, p. 11.

U.S. Department of Commerce, Compendium of State Government Finances in 1958, table five, p. 11.

U.S. Department of Commerce, Compendium of State Government Finances in 1959, table five, p. 11.

Payment of Tax and Penalties

A taxpayer must file his unincorporated business tax return on or before February fifteenth. The return must be properly completed, signed and certified, or else sworn to before a Notary Public. A money order or check payable to the Tax Administrator for the amount of the tax must accompany the return.⁹⁸

If the return is not filed within the prescribed period, a penalty

⁹⁸State of Rhode Island, Division of Taxation, Unincorporated Business Tax Return Instruction Sheet, Instruction 9, Providence, Rhode Island, 1959.

of ten percent per year will be charged on the tax due. If it becomes necessary for an agent of the Tax Administration to obtain a delinquent return, a penalty of twenty-five percent of the tax will be imposed and interest at the rate of six percent per year will be charged on the overdue tax.⁹⁹

Appeals

All appeals with respect to the unincorporated business income tax must be filed with the Tax Administrator within thirty days after the receipt of a tax bill. If the appeal is denied, the taxpayer may apply for a hearing at which time the appeal will be reviewed.¹⁰⁰

⁹⁹State of Rhode Island, Division of Taxation, Unincorporated Business Tax Return Instruction Sheet, Providence, Rhode Island, 1959, Penalties.

¹⁰⁰Ibid.

CHAPTER VI

THE UNINCORPORATED BUSINESS INCOME TAX IN CONNECTICUT

Brief History

In 1921 the General assembly of the state of Connecticut passed a law which levied a tax on the gross income of unincorporated business.¹⁰¹ The model plan of state and local taxation, which was prepared by a committee of the National Tax Association in 1918, under the direction of its chairman, Charles J. Bullock, first directed the attention of the assembly to the possibility of taxing unincorporated business. The model plan proposed a personal income tax, a property tax on tangible property and a business tax. The business tax was to be on the net income of all business regardless of their type of organization.¹⁰² This report was still the center of much controversy when the state of Connecticut enacted its tax on mercantile business other than corporations.¹⁰³

Arguments showing (1) inequality in the existing tax structure, (2) a need for additional revenue, and (3) a desire for maintaining tax rates on real estate as they were, if not for reducing or abolishing

¹⁰¹M. Slade Kendrick, Public Finance, p. 430, Houghton Mifflin Company, New York, 1951.

¹⁰²National Tax Association, "Model System of State and Local Taxation," Proceedings of the Annual Conference, pp. 426-470, 1919.

¹⁰³El Morshidy, Ahmed Mahoud, The Unincorporated Business Tax in The United States with Emphasis on New York, (Ph. D. dissertation, Cornell University, New York, 1953), p. 87.

them, were used as the justification for the impost by the Tax Commissioner in his biennial report of 1921 and 1922.¹⁰⁴

The original levy taxed unincorporated retail, wholesale, and manufacturing enterprises.¹⁰⁵ Service and agriculture businesses were not taxed except to the extent they were engaged in the buying of tangible personal property to be resold for profit. In 1935 the law, however, was expanded and two types of service businesses, amusement and motor transportation, were specifically added.¹⁰⁶

Also added at that time to the list of taxable enterprises was the sale, manufacture, and transportation of alcoholic beverages.¹⁰⁷ The Eighteenth Amendment to the Constitution of the United States of America, which made the manufacture, sale, and transportation of alcoholic beverages illegal, went into effect in 1919.¹⁰⁸ Thus, when Connecticut passed its unincorporated business income tax law, the Eighteenth Amendment was in force. In 1933, the Twenty-first Amendment, which repealed the Eighteenth Amendment, was passed. This no doubt brought about the addition by Connecticut, in 1935, of the sale, manufacture and transportation of alcoholic beverages as taxable enterprises

¹⁰⁴Ibid., p. 88.

¹⁰⁵N. Slade Kendrick, Public Finance, p. 430, Houghton Mifflin Company: New York, 1951.

¹⁰⁶Ibid.

¹⁰⁷Ibid.

¹⁰⁸Charles G. Fenwick, Cases on American Constitutional Law, Fifth Edition, p. XI, Callaghan and Company: Chicago, 1942.

under its unincorporated business income tax.¹⁰⁹ The only other change in the original law was the expansion in 1923 of the definition of wholesale business to include the sale of tangible personal property to consumers at wholesale prices.¹¹⁰

Business Subject to Taxation

The state of Connecticut levies the unincorporated business tax on any individual, judiciary, partnership or association not incorporated, to the extent it is engaged in retail, wholesale, motor transportation, amusement, or manufacturing business within the state.¹¹¹

For the purpose of the unincorporated business tax, the following definitions prevail:¹¹²

- (1) Retail Mercantile Business "... means the buying of tangible personal property and selling the same for profit".
- (2) Wholesale Mercantile Business "... means the buying of tangible personal property and selling the same to be resold at retail for profit or gain".
- (3) Motor Transportation Business "... means the carrying for hire of passengers, or of anything, or commodity, including but not limited to goods, wares, merchandise, and materials in or upon a motor vehicle".

¹¹⁰ N. Slade Kendrick, Public Finance, p. 430, Houghton Mifflin Company: New York, 1951.

¹¹¹ State of Connecticut, Tax Department, Unincorporated Business Tax Law, p. 3, Hartford, Connecticut, Sec. 1955.

¹¹² Ibid.

- (4) Amusement Business "... covers any theatre, opera hall, or other enclosure used for the purpose of conducting motion pictures, motion pictures accompanied by synchronized sound reproduction, plays, vaudeville, musical programs, or any combination of the foregoing".
- (5) Manufacturing "... means the making or changing of articles or materials into suitable forms for use or consumption for profit or gain, or repairing, renovating or cleaning property for profit or gain. In addition to the foregoing manufacturing covers the gross income derived from the building trades, black smithing, tailoring, dying, cleaning laundering, automobile washing, printing, serving meals in restaurants, lunch rooms, or established boarding houses, provided any person who does not employ one or more assistants or supply material shall not be construed as engaged in manufacturing as defined in the law".

As indicated above, the income from personal services and agriculture is not taxable. But income received in the conduct of a service or agricultural business from the buying of tangible personal property, including agricultural products, for resale is taxable. The Connecticut unincorporated business income tax law makes this quite clear. It states that, for the purposes of this impost, certain businesses are construed to be engaged in a mercantile retail or wholesale business with respect to income from merchandise purchased by them for resale. These businesses

are as follows:¹¹³

- (1) barbers shops and beauty parlors,
- (2) boarding schools and camps,
- (3) farmers and florists,
- (4) hotels, boarding houses, and
- (5) undertakers.

Barbers shops and beauty parlors are taxable only on income derived from the sale of merchandise. Persons operating boarding schools and camps are taxed only on the receipts from the sale of food and not rent received. If records are not kept which separate income and rentals, fifty percent is considered as income from the sale of goods.¹¹⁴ Persons operating hotels, boarding houses and similar businesses are taxable only on the receipts from the sale of food and other tangible property, but not on income received from the renting of rooms. If records are not kept separating income from rentals, sixty percent of the total gross income is considered to be taxable.¹¹⁵ Undertakers are supposed to report sixty percent of their total gross income if records are not kept segregating the income from sales of merchandise from that derived from professional services.¹¹⁶ Farmers and florists, people engaged in the sale of animals, sea food, fruit, etc. must report income from sales of

¹¹³State of Connecticut, Tax Department, Unincorporated Business Tax Law, p. 3, Hartford Connecticut, Sec. 1955.

¹¹⁴Ibid.

¹¹⁵Ibid.

¹¹⁶Ibid.

that which was bought and sold, but not produced or raised, by them.¹¹⁷

Gross Income

The unincorporated business tax levied by the state of Connecticut is on gross income. For the purpose of this impost, gross income is defined as:¹¹⁸

... all receipts, whether in the form of money, credits or other valuable consideration received during the income year in connection with any business subject to taxation under the unincorporated business tax law.

There are two types of income which are exempt from this levy:

(1) income from activities carried on by a resident or non-resident business outside the state, and (2) income received in payment of debts which represents gross income included in a previous return made by the taxpayer.¹¹⁹

Tax on Business Partly Conducted in Connecticut

If the entire income of a taxpayer was not from business conducted within the state, the tax is computed only on the gross income received from business that was conducted in the state. Income from sources within the state is determined by separate accounting. If the Tax Commissioner should agree that it is impossible to determine, by separate accounting,

¹¹⁷Ibid.

¹¹⁸State of Connecticut, Tax Department, Unincorporated Business Tax Law, p. 3, Hartford, Connecticut, Sec. 1955.

¹¹⁹Ibid., p. 4.

the amount of gross income received from business conducted in Connecticut, the use of a formula is prescribed.

Where income is derived from retail, wholesale, manufacturing or amusement business, the prescribed formula makes use of one factor, payrolls.¹²⁰ The ratio of payrolls within the state as compared with total payrolls everywhere is the ratio used to determine the amount of gross income to be apportioned to Connecticut. Therefore, the allocation formula is as follows:

$$\frac{\text{Payrolls paid to employees within the state of Connecticut}}{\text{Payrolls paid to employees within and without the state of Connecticut.}} \times 100 = \text{Percentage of gross income to be allocated to Connecticut.}$$

When income is derived from a motor transportation business, a formula with one factor, miles operated, is employed.¹²¹ The tax is computed on such ratio of the entire gross income as the total number of miles operated within the state bears to the total number of miles operated everywhere. Therefore, the allocation percentage is calculated by using the following formula:

$$\frac{\text{Total number of miles operated within the state of Connecticut}}{\text{Total number of miles operated within and without the state of Connecticut.}} \times 100 = \text{Percentage of gross income to be allocated to Connecticut.}$$

¹²⁰State of Connecticut, Tax Department, Unincorporated Business Tax Law, p. 3, Hartford, Connecticut, Sec. 1955.

¹²¹Ibid.

Rate of the Tax

The state of Connecticut applies different rates to wholesale businesses than it does to other types of unincorporated businesses. For retail, manufacturing, motor transportation and amusement businesses, the rate is one dollar per thousand or any part of a thousand (.1 percent), up to and including sixty thousand dollars of gross income. The rate is increased to two dollars per thousand or any part of a thousand (.2 percent), for gross income in excess of sixty thousand dollars.¹²²

The rate applied to wholesale businesses is twenty-five cents per thousand dollars of gross income or any part of a thousand (.025 percent) up to and including sixty thousand dollars. The rate is fifty cents per thousand or any part of a thousand (.05 percent), in excess of sixty thousand dollars.¹²³ The minimum tax for all types of unincorporated business is five dollars.¹²⁴

Revenue

The unincorporated business income tax levied by the state of Connecticut has not been a productive impost. As can be seen on Table IV, the tax yielded a total of \$8,475,781 for the fiscal years 1957, 1958, and 1959. This sum represents only 1.27 percent of the total

¹²²State of Connecticut Tax Department, Unincorporated Business Tax Law, p. 4, Hartford, Connecticut, Sec. 1956.

¹²³Ibid.

¹²⁴Ibid.

tax revenue Connecticut received during these years.

TABLE IV. REVENUE RETURNED TO CONNECTICUT BY ITS
UNINCORPORATED BUSINESS INCOME TAX

Year	Revenue Received From Unincorporated Business Income Tax.	Total Tax Revenue From all Sources	Revenue From the Unin- corporated Business Income Tax as a Percent- age of Total Tax Revenue From all Sources.
1957	\$ 2,965,476	\$227,614,000	1.3
1958	2,866,106	218,786,000	1.3
1959	2,644,199	218,723,000	1.2
Total	\$ 8,475,781	\$665,123,000	1.27

Source: U. S. Department of Commerce, Compendium of State Government Finances in 1957, table five, p. 11.

U. S. Department of Commerce, Compendium of State Government Finances in 1958, table five, p. 11.

U. S. Department of Commerce, Compendium of State Government Finances in 1959, table five, p. 11.

Payment of Tax and Penalties

The unincorporated business tax is due and payable within one hundred and five days from the expiration of the income year. The income year is the fiscal year or the calendar year, whichever the taxpayer chooses to base his business on. If a taxpayer has only carried on business in the state during part of an income year, the period during which the taxpayer has carried on business is treated as the income

year.¹²⁵

As soon as possible after the filing of a return, the Commissioner examines it and determines the amount of the tax. If it should be discovered within three years after the filing of the return that the amount paid is less than the amount which should have been paid, ten percent of the deficiency is added as a penalty.¹²⁶

If the Commissioner upon examination of the return should find that excess payment has been made, a refund may be paid, or the amount may be credited to an amount due from another income year.¹²⁷

A taxpayer who fails to make a return or to pay the amount due within one hundred and five days after the end of his income year, is fined ten percent of the tax.¹²⁸ If an agent of the Commissioner is sent to obtain a delinquent return or to issue a tax warrant for the collection of the tax, a penalty of twenty five percent of the tax is imposed.¹²⁹ A penalty of fifty percent is levied on any income, discovered by the Commissioner through investigation, which was not reported or was incorrectly reported. If the taxpayer can prove to the satisfaction of the Tax Commissioner that the report was not fraudulently filed, the penalty may not exceed fifty dollars.¹³⁰

¹²⁵State of Connecticut Tax Department, Unincorporated Business Tax Law, p. 3, Hartford, Connecticut, Sec. 1955.

¹²⁶State of Connecticut, Tax Department, Unincorporated Business Tax Law, pp. 6-7, Hartford, Connecticut, Sec. 1961.

¹²⁷Ibid.

¹²⁸Ibid.

¹²⁹Ibid.

¹³⁰Ibid.

Any taxpayer who fails to make a return of his gross income or who makes a false statement on the return for the purpose of evading the tax, may be fined not more than one thousand dollars or be given six months in jail or both. If a taxpayer does not pay his unincorporated business tax when due, a penalty of six tenths of one per cent per month may be levied on the unpaid balance.¹³¹

The Tax Commissioner may refrain from assessing the tax on any taxpayer whose gross income is less than two hundred dollars or who has been in business within the state less than thirty days. An individual who is either unable to pay his tax bill and submits evidence of this in the form of an affidavit, or who is receiving state or charitable aid, may have his tax abated by the Tax Commissioner with the approval of the Attorney General.¹³²

Appeals

Any person who does not agree with the Commissioner, with respect to a penalty or the amount of a tax bill, may appeal to the Tax Commissioner for a hearing. The appeal for a hearing must be in writing and must be filed within ten days after the receipt of a tax bill or notice of a penalty. The Commissioner can either grant or deny the hearing. If the Commissioner grants the hearing, he may subpoena witnesses, administer oaths and make inquiries which are necessary to determine the

¹³¹Ibid.

¹³²State of Connecticut, Tax Department, Unincorporated Business Tax Law, pp. 4-5, Hartford, Connecticut, Sec. 1956.

amount of tax due.¹³³

If the taxpayer is not satisfied with the outcome of the hearing, he may, within thirty days, appeal to the court of Common Pleas. At this hearing the court may affirm or correct the action of the Tax Commissioner.¹³⁴

¹³³Ibid., Sec. 1969.

¹³⁴Ibid.

CHAPTER VII

REVENUE FOR SOUTH DAKOTA

As can be seen from the previous discussion, there are two types of unincorporated business income taxes levied in the United States. Rhode Island and Connecticut base their impost upon gross receipts while New York and the District of Columbia base their tax upon net income.

The objective of this chapter is to obtain an estimate of the revenue that an unincorporated business income tax would return to South Dakota. The different methods of levying an unincorporated business income tax will be applied to available income data for South Dakota in order to arrive at this estimate.

The data used to make the revenue estimate referred to above were obtained from publications of the United States Department of Commerce. The Department of Commerce compiled their data by means of a mail canvass in which report forms were mailed to all South Dakota business firms included in the active record of the United States Internal Revenue Service.¹³⁵

It should be noted that the above data has not been subjected to any type of allocation procedure because the information necessary to make an apportionment is not available. Therefore, all the income of unincorporated businesses in South Dakota has been considered to be taxable by South Dakota, even though some of it may have resulted from

¹³⁵United States Department of Commerce, Bureau of the Census, "Wholesale Trade South Dakota," 1958 Census of Business, Appendix, 1958.

activities carried on outside the state. On the other hand, the income earned from business carried on in South Dakota by unincorporated businesses located in other states, which would normally be taxable by South Dakota, has also not been included in the income data. According to H. C. Welch, the District Director of Internal Revenue at Aberdeen, South Dakota, the omission of the income earned in South Dakota by non-South Dakota unincorporated firms should offset the lack of apportionment of the income of unincorporated businesses located in the state. Thus, the income data used should be approximately correct.

Another point should be noted. The income data used are for the calendar year 1958. This is the most recent period for which such data were available. It is assumed throughout this chapter and the Summary and Conclusions that the income of unincorporated business in South Dakota has not changed markedly since 1958. Therefore, the revenue estimates made on the basis of the 1958 income data are assumed to be reasonably correct, if an unincorporated business income tax were to be adopted by South Dakota in the near future.

Gross Income Method

The unincorporated business income tax levied by Rhode Island and Connecticut are the same with few exceptions. Two of the major differences in the imposts are: (1) Rhode Island allows a five thousand dollar deduction from gross income and thirty thousand dollars of exempt income while Connecticut allows neither deduction;¹³⁶ and (2) the rate

¹³⁶State of Rhode Island Division of Taxation, Unincorporated Business Tax Return, Instruction Sheet, Instruction 5, Providence, Rhode Island, 1959.

used by Connecticut is graduated while the rate used by Rhode Island is a flat rate.¹³⁷

On the following tables, the rates used by Rhode Island and Connecticut have been applied to the gross receipts of retail, wholesale and service (including amusement) business in South Dakota.

The rates are not applied to the gross receipts of agriculture because these states do not tax agriculture on products grown or raised. They tax only the products of agriculture which are bought and sold for profit.

Table V shows the expected revenue from South Dakota retail businesses when Rhode Island tax rates are applied to their gross incomes. The total revenue South Dakota could expect to receive from a tax of this type at Rhode Island rates is \$957,000.

Table VI shows the Rhode Island tax rates applied to South Dakota amusement and service businesses. The expected revenue, however, is zero. The reason for this is that the average amusement and service business in South Dakota does not have gross receipts in excess of \$35,000.

Table VII shows the revenue South Dakota could expect to receive from an unincorporated business tax on wholesale businesses if the rates of the Rhode Island tax were to be applied to their receipts. If South Dakota were to adopt such an unincorporated business tax on gross receipts, the expected revenue from wholesale businesses would be \$889,000.

¹³⁷State of Connecticut Tax Department, Unincorporated Business Tax Law, p. 22, Hartford, Connecticut, Sec. 1956.

TABLE V. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED RETAIL BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY RHODE ISLAND

(1)	(2)	(3)	(4)	(5)	(6)	(7) Tax	(8)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales (Col. 3) (in \$1000's)	Average Sales Minus \$5000 Deduction (Col. 4) (in \$1000's)	Taxable Income (Col. 5) (\$30,000) (in \$1000's) ^a	Average Tax per Business at the Rate of Two Dollars per Thousand (Col. 6 X \$2.00) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 7) (in Dollars)
Lumber, Building material, Hardware, and Equipment	1,273	147,224	116	111	81	162	206,000
General Merchandise	431	66,834	155	150	120	240	103,000
Food Stores	1,186	153,426	129	124	94	188	223,000
Auto Dealers	511	135,901	266	261	231	462	236,000
Gasoline Stations	1,163	66,612	57	52	22	44	51,000
Apparel and Accessory Stores	422	35,566	84	79	49	98	41,000
Furniture	436	28,443	65	60	30	60	26,000
Eating and Drinking	1,683	48,479	29	24	0	0	0
Drug and Proprietary Stores	275	25,571	93	88	58	116	32,000
Other Retail Stores	1,110	58,658	53	48	18	36	39,000
Non Store Retailers	268	5,118	19	14	0	0	0
Total Expected Revenue							\$957,000

*The tax in Rhode Island is imposed on gross income in excess of thirty thousand dollars.

Source: United States Department of Commerce, Bureau of the Census, "Retail Trade South Dakota," 1958 Census of Business, table 100.

TABLE VI. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED AMUSEMENT AND SERVICE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY RHODE ISLAND

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales (Col. 3) (in \$1000's)	Average Sales Minus Deduction (Col. 4 - \$5000) (in \$1000's) ^a	Taxable Income (Col. 5 - \$30,000) (in \$1000's) ^a	Average Tax per Business at the Rate of Two Dollars per Thousand (Col. 6 X \$2.00) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 7) (in Dollars)
Laundries	214	6,927	32	28	0	0	0
Beauty Shops	365	2,353	7	2	0	0	0
Barber Shops	436	2,342	5	0	0	0	0
Photo Studios	53	1,007	19	14	0	0	0
Shoe Repair, Shoe Shine	105	708	7	2	0	0	0
Funeral Service	87	3,060	35	30	0	0	0
Garment Repair, Altering and Pressing					0	0	0
Fur Repair and Storage	51	410	8	3	0	0	0
Misc. Personal Service	59	207	4	0	0	0	0
Auto Repair, & Garages	631	11,438	18	13	0	0	0
Misc. Repair Services	650	5,924	9	4	0	0	0
Motion Pictures	155	3,841	25	20	0	0	0
Amusement, Recreation services other than Motion Pictures	425	8,588	20	15	0	0	0
Total Expected Receipts							0

^aThe tax in Rhode Island is imposed on gross income in excess of thirty-thousand dollars.

*Source: United States Department of Commerce, Bureau of the Census, "Selected Services South Dakota," 1958 Census of Business, table 100.

TABLE VII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY RHODE ISLAND

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business	Number of Businesses*	Sales or Gross Receipts (in \$1000's)* (in \$1000's)	Average Sales (Col. 3) (in \$1000's)	Average Sales Minus \$5000 Deduction (Col. 4 - \$5000) (in \$1000's)	Taxable Income (Col. 5 - \$30,000) (in \$1000's) ^a	Average Tax per Business at the Rate of Two Dollars per Thousand (Col. 6 X \$2.00) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 7) (in Dollars)
Motor Vehicles, Auto Equipment	86	22,509	262	257	227	227	20,000
Drugs, Chemicals, & Allied Products	22	8,719	396	391	361	361	8,000
Dry Goods, Apparel	2	460	230	225	195	195	400
Groceries, Selected Products	79	102,754	1,301	1,296	1,266	1,266	100,000
Farm Products, Raw Material	549	516,251	940	935	905	905	497,000
Electrical Goods	28	16,806	600	595	565	565	16,000
Hardware, Plumbing & Heating Equipment	26	13,218	508	503	473	473	12,000
Machinery, Equipment & Supplies	106	70,012	660	655	625	625	66,000
Metals and Minerals	3	460	153	148	118	118	400
Petroleum, Bulk Station & Terminals	588	114,712	195	190	160	160	94,000
Scrap, Waste Materials	34	2,744	81	76	46	46	2,000
Tobacco, Tobacco Products	13	11,309	870	865	836	836	11,000
Beer, Wine, Distilled Alcoholic Beverages	52	21,245	409	404	374	374	19,000
Paper, Paper Products	9	2,869	319	314	284	284	3,000
Furniture, Home Furnishings	6	460	77	72	42	42	300
Materials	34	17,209	506	501	471	471	16,000
Amusement, Sporting Goods	9	2,684	298	293	263	263	2,000
Books, Magazines, Newspapers	5	871	174	169	139	139	700

TABLE VII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY RHODE ISLAND (CONTINUED)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales (Col. 3) (in \$1000's)	Average Sales Minus \$5000 Deduction (Col. 4) (in \$1000's)	Taxable Income (Col. 5) (\$30,000) (in \$1000's) ^a	Average Tax per Business at the Rate of Two Dollars per Thousand (Col. 6 X \$2.00) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 7) (in Dollars)
Farm Supplies	32	14,552	455	450	420	420	13,000
Jewelry	2	460	230	225	195	195	400
Petroleum Products	26	4,560	175	170	140	140	4,000
Gifts, Art Goods, Greeting Cards	1	460	460	455	425	425	400
Flowers, Bulbs, Plants	1	460	460	455	425	425	400
Other Products	15	3,515	234	229	199	199	3,000
Total Expected Receipts							\$889,000

^aThe Tax in Rhode Island is levied on gross income in excess of thirty thousand dollars.

*Source: United States Department of Commerce, Bureau of the Census, "Wholesale Trade South Dakota," 1958 Census of Business, table 100.

Tables VIII, IX, and X are concerned with the expected revenue from retail, service, and wholesale businesses in South Dakota using the Connecticut method of taxing unincorporated businesses. The revenue South Dakota could expect to receive, according to type of business, if such an unincorporated business tax on gross receipts were adopted is as follows: (1) retail \$1,330,000.00; (2) service and amusement \$47,000.00; and (3) wholesale \$412,000.00.

TABLE XI. COMPARISON OF THE EXPECTED REVENUE FOR SOUTH DAKOTA USING THE CONNECTICUT AND RHODE ISLAND GROSS INCOME METHODS OF TAXING UNINCORPORATED BUSINESS IN SOUTH DAKOTA

Types of Business	Expected Receipts	
	Rhode Island Method	Connecticut Method
Retail	\$ 959,000	\$1,330,000
Service - Amusement	0	47,000
Wholesale	889,000	412,000
Totals	\$1,848,000	\$1,789,000

Source: See Tables V-X, pp. 60-68.

Table XI is a comparison of the expected revenues using the Connecticut and Rhode Island methods. The Connecticut method would provide higher revenue from retail businesses and from service and amusement businesses, while the Rhode Island method would give a higher expected revenue from wholesale businesses. The total expected revenue using the Rhode Island method is higher than the total expected revenue using

TABLE VIII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED RETAIL BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY CONNECTICUT

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales (Col. 3) (in \$1000's)	Average Tax on the First \$60,000 of Gross Receipts at the Rate of \$1.00 per \$1,000 (in Dollars)	Average Tax on the Balance of Gross Receipts at the Rate of \$2.00 per \$1,000. (Col. 4-Col. 5 X \$2.00 (in Dollars)	Total Average Tax (Col. 5 + Col. 6) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 2 X Col. 7) (in Dollars)
Lumber, Building Materials, Hardware & Equipment Dealers	1,273	147,224	116	60	112	172	219,000
General Merchandise Store	431	66,834	155	60	190	250	108,000
Food Stores	1,186	153,426	129	60	338	398	472,000
Auto Dealers	511	135,901	266	60	412	472	241,000
Gasoline Stations	1,163	66,612	57	57	0	57	66,000
Apparel & Accessory Stores	422	35,566	84	60	48	108	45,000
Furniture and Equipment	436	28,443	65	60	10	70	31,000
Eating and Drinking	1,683	48,479	29	29	0	29	49,000
Drugstore, Proprietary	1,275	25,571	93	60	66	126	35,000
Other Retail Stores	1,110	58,658	53	53	0	53	59,000
Non Store Retailers	268	5,118	19	19	0	19	5,000
Total Expected Receipts							\$1,330,000

*Source: United States Department of Commerce, Bureau of the Census, "Retail Trade South Dakota," 1958 Census of Business, table 100.

TABLE IX. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED AMUSEMENT AND SERVICE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY CONNECTICUT

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales (Col. 2) (in \$1000's)	Average Tax on the First \$60,000 of Gross Receipts at the Rate of \$1.00 per \$1,000 (Col. 5)	Average Tax on the Balance of Gross Receipts at the Rate of \$2.00 per \$1,000 (Col. 4-Col. 5 X \$2.00) (in Dollars)	Total Average Tax (Col. 5 + Col. 6) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 8) (in Dollars)
Laundries	214	6,927	32	32	0	32	7,000
Beauty Shops	365	2,353	7	7	0	7	3,000
Barber Shops	436	2,342	5	5	0	5	2,000
Photo Studios	53	1,007	19	19	0	19	1,000
Shoe Repair, Shoe Shine	105	708	7	7	0	7	700
Funeral Service	87	3,060	35	35	0	35	3,000
Garment Repair, Altering, and Pressing, Fur Repair, and Storage	51	410	8	8	0	8	400
Misc. Personal Service	59	207	4	4	0	4	200
Auto Repair, & Garages	631	11,438	18	18	0	18	11,000
Misc. Repair Services	650	5,924	9	9	0	9	6,000
Motion Pictures	155	3,841	25	25	0	25	4,000
Amusement, Recreation Services Other than Motion Pictures	425	8,588	20	20	0	20	9,000
Total Expected Revenues							\$47,000

*Source: United States Department of Commerce, Bureau of the Census, "Selected Services South Dakota," 1958 Census of Business, table 100.

TABLE X. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY CONNECTICUT

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business*	Number of Businesses* (in \$1000's)*	Sales or Gross Receipts (in \$1000's)* (Col. 3)	Average Sales (Col. 3) (Col. 4)	Average Tax on the First \$60,000 of Gross Receipts at the Rate of \$1.00 per \$1,000 (in Dollars) (Col. 5)	Average Tax on the Balance of Gross Receipts at the Rate of \$2.00 per \$1,000 (Col. 4-Col. 5 X \$2.00 (in Dollars) (in Dollars) (Col. 6)	Total Average Tax (Col. 5 + Col. 6) (in Dollars) (in Dollars) (Col. 7)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 8) (in Dollars) (in Dollars) (Col. 8)
Motor Vehicles, Auto Equipment	86	22,509	262	15	101	116	10,000
Drugs, Chemicals, Allied Products	22	8,719	396	15	168	198	4,000
Dry Goods, Apparel	2	460	230	15	85	100	200
Groceries, Selected Products	79	102,754	1,301	15	621	176	14,000
Farm Products, Raw Materials	549	516,251	940	15	440	455	250,000
Electrical Goods	28	16,806	600	15	270	285	8,000
Hardware, Plumbing & Heating Goods	26	13,218	508	15	224	239	6,000
Machinery, Equipment, & Supplies	106	70,012	660	15	300	315	33,000
Metals & Minerals	3	460	153	15	46	61	200
Petroleum, Bulk Stations and Terminals	588	114,712	195	15	67	82	48,000
Scrap, Waste Materials	34	2,744	81	15	10	25	900
Tobacco, Tobacco Plants	13	11,309	870	15	405	420	5,000
Beer, Wine, Distilled	52	21,245	409	15	175	190	10,000
Alcoholic Beverages	9	2,869	319	15	129	144	1,000
Paper and Paper Products	9	460	77	15	8	23	100
Furniture, Home Furnishings	6	460	77	15	8	23	100
Lumber and Construction Materials	34	17,209	506	15	223	238	8,000
Amusement, Sporting Goods	9	2,684	298	15	119	134	1,000

TABLE X. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE GROSS INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY CONNECTICUT (CONTINUED)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)* (in \$1000's)	Average Sales (Col. 2) (in \$1000's)	Average Tax on the First \$60,000 of Gross Receipts at the Rate of \$1.00 per 1,000 (Col. 2)	Average Tax on the Balance of Gross Receipts at the Rate of \$2.00 per 1,000 (Col. 4-Col. 5 X \$2.00 (in Dollars)	Total Average Tax (Col. 5 + Col. 6) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 7 X Col. 8) (in Dollars)
Books, Magazines, Newspapers	5	871	174	15	57	72	400
Farm Supplies	32	14,552	455	15	197	212	7,000
Jewelry	2	460	230	15	85	100	200
Petroleum Products	26	4,560	175	15	57	72	2,000
Gifts, Art Goods, Greeting Cards	1	460	460	15	200	215	200
Flowers, Bulbs, & Plants	1	460	460	15	200	215	200
Other Products	15	3,515	234	15	87	102	2,000
Total Expected Receipts							\$412,000

*Source: United States Department of Commerce, Bureau of the Census, "Wholesale Trade South Dakota," 1958 Census of Business, table 100.

the Connecticut method, but the difference is small.

Net Income Method

The state of New York and the District of Columbia levy an unincorporated business tax based upon net income. Both the state of New York and the District of Columbia allow a five thousand dollar deduction from net income before any tax is imposed.¹³⁸ The rate of the tax is four percent in New York and five percent in the District of Columbia.¹³⁹

On the following tables, the rates used by New York and the District of Columbia have been applied to the estimated net income of retail, wholesale, and service businesses in South Dakota.

Net income data for South Dakota unincorporated businesses was not available. To obtain net income estimates, gross income data were used and net income estimated at four and one-half percent of gross income. The basis for the estimate was an article, "Americans Show Startling Ignorance About Capitalism," by Dr. George Gallop, in which he estimates net income as being between three and six percent of gross income.¹⁴⁰ Four and one-half percent, the midpoint between three and six percent, was used because it is an average figure.

Table XII shows the expected revenue from South Dakota retail

¹³⁸New York State Tax Commission, "Unincorporated Business Tax," Manual 55, p. 238, New York, October 1955.

¹³⁹District of Columbia, Income and Franchise Tax Law and Regulations, p. 21, Washington, D.C., 1959.

¹⁴⁰George Gallop, "Americans Show Startling Ignorance About Capitalism," Sioux Falls Argus Leader, Wed., Sept. 3, 1958, Sioux Falls, South Dakota, p. 12, columns 1, 2 and 3.

TABLE XII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED RETAIL BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE STATE OF NEW YORK

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4 X 4.5%) (in Dollars)	Average Tax Per Business at the Rate of 4% (Col. 5 X 4%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 X Col. 2) (in Dollars)
Lumber, Building Material and Hardware Dealers	1,273	147,224	116	5,140	206	262,000
General Merchandise Stores	431	66,834	155	6,980	279	120,000
Food Stores	1,186	153,426	129	5,710	228	275,000
Auto Dealers	511	135,901	266	11,970	479	245,000
Gasoline Stations	1,163	66,612	57	2,570	103	119,000
Apparel & Accessory	422	35,566	84	3,780	151	64,000
Furniture & Equipment	436	28,443	65	2,930	117	51,000
Eating & Drinking	1,683	48,479	29	1,310	52	88,000
Drug & Proprietary Stores	275	25,571	93	4,190	168	46,000
Other Retail Stores	1,110	58,658	528	23,760	950	106,000
Non Store Retailers	268	5,118	19	860	34	9,000
Total Expected Revenue						\$1,389,000

*Source: United States Department of Commerce, Bureau of the Census, "Retail Trade South Dakota," 1958 Census of Business, Table 100.

business when the New York rate of four percent is applied to their estimated net incomes. The total revenue South Dakota could expect to receive from retail businesses, using the New York rate, is \$1,389,000.

Table XIII shows the same computation for South Dakota amusement and service businesses. The expected revenue is \$83,000. Table XIV shows the revenue South Dakota could expect to receive from an unincorporated business tax on wholesale businesses using the New York rate of four percent. If South Dakota were to adopt an unincorporated business tax on net income, the expected revenue from wholesale businesses, using the New York rate, would be \$1,708,000.

Table XV, XVI, and XVII deal with expected revenue from retail, service, and wholesale businesses in South Dakota using the District of Columbia rate of five percent of net income. South Dakota could expect to receive, if a tax on the net income of unincorporated businesses at the rate of five percent were adopted, the following revenue: (1) from retail businesses, \$1,736,000; (2) from amusement and service businesses \$104,000; and (3) from wholesale businesses, \$2,135,000.

TABLE XIII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED AMUSEMENT AND SERVICE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE STATE OF NEW YORK

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4 X 4.5%) (in Dollars)	Average Tax Per Business at the Rate of 4% (Col. 5 X 4%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 X Col. 2) (in Dollars)
Laundries	214	6,927	32	1,440	58	12,000
Beauty Shops	365	2,353	7	315	13	4,000
Barber Shops	436	2,342	5	225	9	4,000
Photo Studios	53	1,007	19	855	34	2,000
Shoe Repair & Shine	105	708	7	315	13	1,000
Funeral Service	87	3,060	35	1,575	47	5,000
Garment Repair, Altering and Pressing; fur						
Repair and Storage	51	410	8	360	14	700
Misc. Personal Services	59	207	4	180	7	400
Auto Repair & Garages	631	11,438	18	810	32	20,000
Misc. Repair Services	650	5,924	9	405	16	11,000
Motion Pictures	155	3,841	25	1,125	45	7,000
Amusement and Recreation						
Services Other than Motion Pictures	425	8,588	20	900	36	15,000
Total Expected Revenue.....						\$83,000

*Source: United States Department of Commerce, Bureau of the Census, "Selected Services South Dakota," 1958 Census of Business, Table 100.

TABLE XIV. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE STATE OF NEW YORK

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4 X 4.5%) (in Dollars)	Average Tax Per Business at the Rate of 4% (Col. 5 X 4%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 X Col. 2) (in Dollars)
Motor Vehicles, Auto Equipment	86	22,509	262	11,790	472	41,000
Drugs, Chemicals & Allied Products	22	8,719	396	17,820	713	16,000
Dry Goods & Apparel	2	460	230	10,350	414	800
Groceries & Selected Products	79	102,754	1,301	58,545	2341	185,000
Farm Products & Raw Materials	549	516,251	940	42,300	1692	929,000
Electrical Goods	28	16,806	600	27,000	1080	30,000
Hardware, Plumbing & Heating Equipment	26	13,218	508	22,860	914	24,000
Machinery, Equipment, & Supplies	106	70,012	660	29,700	1188	126,000
Metals and Minerals	3	460	153	6,885	275	800
Petroleum Bulk Stations	588	114,712	195	8,775	351	206,000
Scrap and Waste	34	2,744	81	3,645	145	5,000
Tobacco and Tobacco Products	13	11,309	870	39,150	1566	20,000
Beer, Wine, Distilled Alcoholic Beverages	52	21,245	409	18,405	736	38,000
Paper & Paper Products	9	2,869	319	14,355	574	5,000
Furniture & Home Furnishings	6	460	77	3,465	139	800
Lumber & Construction Materials	34	17,209	506	22,770	911	31,000
Amusement & Sporting Goods	9	2,684	298	13,410	536	5,000
Books, Magazines, & Newspapers	5	871	174	7,830	313	2,000

TABLE XIV. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE STATE OF NEW YORK (CONTINUED)

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4 X 4.5%) (in Dollars)	Average Tax Per Business at the Rate of 4% (Col. 5 X 4%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 X Col. 2) (in Dollars)
Jewelry	2	460	230	10,350	414	800
Farm Supplies	32	14,552	455	20,475	819	26,000
Petroleum Products	26	4,560	175	7,875	315	8,000
Gifts, Art Goods, Greeting Cards	1	460	460	20,700	828	800
Flowers, Bulbs, & Plants	1	460	460	20,700	828	800
Other Products	15	3,515	234	10,530	421	6,000
Total Expected Revenue						\$1,708,000

*Source: United States Department of Commerce, Bureau of the Census, "Wholesale Trade South Dakota," 1958 Census of Business, Table 100.

TABLE XV. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED RETAIL BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE DISTRICT OF COLUMBIA

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income Col. 4 X 4.5% (in Dollars)	Average Tax Per Business at the Rate of 5% Col. 5 X 5% (in Dollars)	Total Expected Tax Revenue by Type of Business Col. 6 X Col. 2 (in Dollars)
Lumber, Building Material, and Hardware Dealers	1,273	147,224	116	5,140	261	332,000
General Merchandise Stores	431	66,834	155	6,980	349	150,000
Food Stores	1,186	153,426	129	5,710	290	344,000
Auto Dealers	511	135,901	266	11,970	599	306,000
Gasoline Stations	1,163	66,612	57	2,570	128	149,000
Apparel & Accessory	422	35,566	84	3,780	189	80,000
Furniture & Equipment	436	28,443	65	2,930	146	64,000
Eating & Drinking	1,683	48,479	29	1,310	65	110,000
Drug & Proprietary Stores	275	25,571	93	4,190	209	58,000
Other Retail Stores	1,110	58,658	528	23,760	119	132,000
Total Expected Revenue						\$1,736,000

*Source: United States Department of Commerce, Bureau of the Census, "Retail Trade South Dakota," 1958 Census of Business, Table 100.

TABLE XVI. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED AMUSEMENT AND SERVICE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE DISTRICT OF COLUMBIA

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4x4.5%) (in Dollars)	Average Tax per Business at the Rate of 5% (Col. 5 x 5%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 x Col. 2) (in Dollars)
Laundries	214	6,927	32	1,440	72	15,000
Beauty Shops	365	2,353	7	315	14	5,000
Barber Shops	436	2,342	5	225	11	5,000
Photo Studios	53	1,007	19	855	43	2,000
Shoe Repair & Shine	105	708	7	315	16	2,000
Funeral Service	87	3,060	35	1,575	79	7,000
Garment Repair, Altering and Pressing; and Fur Repair & Storage	51	410	8	360	18	900
Misc. Personal Services	59	207	4	180	9	500
Auto Repair & Garages	631	11,438	18	810	41	26,000
Misc. Repair Services	650	5,924	9	405	20	13,000
Motion Pictures	155	3,841	25	1,125	56	9,000
Amusement & Recreation Services Other Than Motion Pictures	425	8,588	20	900	45	19,000
Total Expected Revenue						\$104,000

*Source: United States Department of Commerce, Bureau of the Census, "Selected Services South Dakota," 1958 Census of Business, Table 100.

TABLE XVII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE DISTRICT OF COLUMBIA

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business*	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4 X 4.5%) (in Dollars)	Average Tax Per Business at the Rate of 5% (Col. 5 X 5%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 X Col. 2) (in Dollars)
Motor Vehicles, Auto Equipment	86	22,509	262	11,790	590	51,000
Drugs, Chemicals, & Allied Products	22	8,719	306	17,820	891	20,000
Dry Goods & Apparel	2	460	230	10,350	518	1,000
Groceries & Selected Products	79	102,754	1,301	58,545	2,927	231,000
Farm Products & Raw Materials	549	516,251	940	42,300	2,115	1,161,000
Electrical Goods	28	16,806	600	27,000	1,350	38,000
Hdwe., Plumbing & Heating Equipment	26	13,218	508	22,860	1,143	30,000
Machinery, Equipment & Supplies	106	70,012	660	29,700	1,485	157,000
Metals & Minerals	3	460	153	6,885	300	1,000
Petroleum Bulk Stations	588	114,712	195	8,775	439	258,000
Scrap & Waste Materials	34	2,744	81	3,645	182	6,000
Tobacco & Tobacco Products	13	11,309	870	39,150	1,958	25,000
Beer, Wine, Distilled						
Alcoholic Beverages	52	21,245	409	18,405	920	48,000
Paper & Paper Products	9	2,869	319	14,355	718	6,000
Furniture and Home Furnishings	6	460	77	3,465	173	1,000
Lumber and Construction Materials	34	17,209	506	22,770	1,139	39,000
Amusement & Sporting Goods	9	2,684	298	13,410	671	6,000
Books, Magazines, and Newspapers	5	871	174	7,830	392	2,000
Jewelry	2	460	230	10,350	518	1,000

TABLE XVII. REVENUE THAT SOUTH DAKOTA MIGHT HAVE RECEIVED IN 1958 FROM AN INCOME TAX LEVIED UPON THE NET INCOME OF ITS UNINCORPORATED WHOLESALE BUSINESSES IF THE TAX HAD USED THE STRUCTURE OF THE IMPOST LEVIED BY THE DISTRICT OF COLUMBIA (CONTINUED)

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Kind of Business	Number of Businesses*	Sales or Gross Receipts (in \$1000's)*	Average Sales Col. 3 Col. 2 (in \$1000's)	Average Net Income (Col. 4 X 4.5%) (in Dollars)	Average Tax Per Business at the Rate of 5% (Col. 5 X 5%) (in Dollars)	Total Expected Tax Revenue by Type of Business (Col. 6 X Col. 2) (in Dollars)
Farm Supplies	32	14,442	455	20,475	1,015	33,000
Petroleum Products	26	4,560	175	7,875	394	10,000
Gifts, Art Goods, Greeting Cards, Flowers, Bulbs, & Plants	1	460	460	20,700	1,035	1,000
Other Products	15	460	460	20,700	1,035	1,000
		3,515	234	10,530	527	8,000
Total Expected Revenue						\$2,135,000

*Source: United States Department of Commerce, Bureau of the Census, "Wholesale Trade South Dakota," 1958 Census of Business, Table 100.

TABLE XVIII. COMPARISON OF EXPECTED REVENUE FOR SOUTH DAKOTA USING
THE NEW YORK AND DISTRICT OF COLUMBIA NET INCOME METHODS OF
TAXING UNINCORPORATED BUSINESS IN SOUTH DAKOTA

Type of Business	Expected Receipts	
	New York Rate	District of Columbia Rate
Retail	\$1,389,000	\$1,736,000
Service - Amusement	83,000	104,000
Wholesale	<u>1,708,000</u>	<u>2,135,000</u>
Totals	\$3,180,000	\$3,975,000

Source: Tables XII-XVII, pp. 70-77.

Table eighteen is a comparison of expected revenue using the New York and the District of Columbia rates. With the New York rate of four percent, an unincorporated business tax on net income would yield \$3,180,000. An unincorporated business tax on net income using the District of Columbia rate of five percent of net income would yield \$3,975,000.

CHAPTER VIII

SUMMARY AND CONCLUSIONS

Summary

Three states and the District of Columbia were found to levy an unincorporated business income tax. The three states were New York, Rhode Island, and Connecticut.

Connecticut, in 1921, was the first state to levy an unincorporated business income tax. Fourteen years later, in 1935, New York levied its impost. Then, the state of Rhode Island imposed an unincorporated business income tax in 1942 and was followed by the District of Columbia in 1947.

The District of Columbia and the state of New York levy the unincorporated business income tax on net income. New York, which recently adopted the federal income tax definition for gross and net income, taxes net income at the rate of four percent and allows a five thousand dollar deduction from net income. The District of Columbia does not allow a deduction from net income and has a higher rate, five percent of net income, than does the state of New York.

The states of Connecticut and Rhode Island levy the unincorporated business income tax on gross income. Connecticut has a graduated rate for all types of business and taxes wholesale business at a lower rate than it does other businesses. The rate for wholesale business is twenty-five cents per one thousand dollars of gross receipts (.025 percent) up to sixty thousand dollars of gross income, and fifty cents per one

thousand dollars of gross receipts (.05 percent) in excess of sixty thousand dollars. The rate in Connecticut for other business is one dollar per thousand dollars of gross receipts (.1 percent) up to sixty thousand dollars of gross income and two dollars per thousand (.2 percent) on the balance.

Rhode Island does not have a graduated rate but it applies a lower rate to wholesale business than it does to other types of business. The rate for wholesale business is one dollar per one thousand dollars of gross receipts (.1 percent) in excess of thirty thousand dollars. The rate for other businesses in Rhode Island is two dollars per one thousand dollars of gross receipts (.2 percent) in excess of thirty thousand dollars.

The unincorporated business tax levied by the state of New York yielded \$30,757,208 in 1959 while in the same year, the impost levied by the District of Columbia yielded \$1,503,971. Connecticut, in 1959, received \$2,644,199 from its impost while the State of Rhode Island in 1959, received only \$817,922.

Table XIX gives a comparison of the expected receipts of an unincorporated business income tax on retail, service, and wholesale business in South Dakota. The different methods and rates used by the three states and the District of Columbia have been applied to the gross and net income data for South Dakota business. The gross income methods used by the states of Rhode Island and Connecticut would yield less total revenue than would the net income methods employed by the state of New York and the District of Columbia. The total expected revenue from the methods used by the states of Rhode Island and Connecticut is

\$1,848,000 and \$1,789,000 respectively. The New York net income method would yield \$3,180,000 in revenue for South Dakota, while the state could expect to receive \$3,975,000 if it were to adopt the District of Columbia's net income method of taxing unincorporated businesses.

TABLE XIX. A COMPARISON OF THE AMOUNTS OF REVENUE SOUTH DAKOTA COULD EXPECT TO RECEIVE FROM THE DIFFERENT METHODS OF TAXING THE INCOME OF UNINCORPORATED BUSINESS

Type of Business	Gross Income Methods		Net Income Methods	
	Connecticut	Rhode Island	District of Columbia	New York
Retail	\$1,330,000	\$ 959,000	\$1,736,000	\$1,389,000
Service - Amusement	47,000	0	104,000	83,000
Wholesale	412,000	889,000	2,135,000	1,708,000
Total	\$1,789,000	\$1,848,000	\$3,975,000	\$3,180,000

Source: See Table XI, p. 64 and Table XVIII, p. 79.

Conclusions

If South Dakota should choose to adopt an unincorporated business income tax, decisions would have to be made with respect to the following structural considerations: (1) business that would be subject to the impost; (2) the base of the levy and (3) the allocation procedure.

What Business Should be Taxed

The District of Columbia and the three states which levy an unincorporated business income tax impose the tax on the following

businesses: (1) retail, (2) wholesale, (3) service and amusement, (4) manufacturing, and (5) transportation. The professions and agriculture are not taxed except on products bought and sold for profit. The reason the above five types of business were chosen for taxation is that they are not prohibited either by law or custom from incorporation and, hence, they can escape by choice the corporation income taxes levied by these states. Since it is the opinion of the author that an unincorporated business income tax should not be levied by South Dakota unless a corporation income tax is also imposed, the author is in complete agreement with this procedure.

The Base of the Impost

As shown earlier in this study, present unincorporated business income taxes are based on gross or net income. In deciding which base, gross or net income, would be best for South Dakota, three points should be considered: (1) revenue, (2) equity, and (3) ease of administration and cost of collection.

The first part of this chapter, the Summary, has shown how much revenue South Dakota could expect to receive from an unincorporated business income tax. Table XIX is a comparison of expected revenue using gross and net income as bases for an unincorporated business income tax. It can be seen, from the table, that a levy with net income as its base would probably yield more revenue than would a tax which used gross income as a base.

A tax which has gross income as its base is certainly not equitable in light of present day values. This method of taxation fails to

take into consideration that a business with a low gross income may have a larger profit margin, sales minus cost, than a business with a high gross income and, hence, have a larger net income or profit. In other words, if two businesses had the same gross income they would pay an equal amount of tax even if they made different amounts of profit.

The gross income tax does, however, have the advantage of simplicity because a taxpayer does not have to compute deductions from gross receipts to arrive at taxable income. The simplicity of the tax form lends itself to ease of administration as well, because returns are easier to check and taxpayers are not as prone to make mistakes.

A tax on net income requires that a taxpayer fill out a more complex return than does a tax on gross income. The state of New York has, to some extent, overcome this difficulty by adoption of a tax form similar to that used for federal income tax purposes. Thus the taxpayer may transfer, with few exceptions, the same information from the federal return to the state return or visa versa.¹⁴¹ The duplication of returns has an advantage other than simplicity, because it provides the state of New York with a check on its tax returns. The state of New York and the federal government work together to uncover mistakes and attempts to defraud either the state or the federal government, and a mistake discovered in either return is reported to the other agency. In this way a double check on a taxpayers return is provided.

¹⁴¹ See page 16 for the differences between the New York unincorporated business income tax and the federal income tax definitions of gross and net income.

Data as to the cost of collection of the unincorporated business income tax were available in only one instance. Rhode Island reports that it costs, for administration, about three and one-half cents of every tax dollar collected. In the other states, the cost of administering a particular tax is not separated from the cost of administering all taxes. It would, however, be reasonable to assume that the cost of collecting a net income tax would be higher than the cost of collecting a gross income tax because the tax form would require more extensive checking.

Allocation

Should South Dakota adopt an unincorporated business income tax, the problem of how to deal with income from businesses which operate both within and without South Dakota would have to be solved. There are two methods of dealing with this problem: (1) separate accounting and (2) the formula method.

Separate accounting determines the portion of income to be allocated to the taxing state by treating the business within the state as though it were separate and distinctive from business carried on outside the state. This method of allocation has the theoretical advantage of being most equitable because it only taxes income actually derived from sources within the state. The separate accounting method does, however, have two disadvantages: (1) some businesses do not keep records which differentiate between income earned from business within the state and income earned from business outside the state; and (2) if a business does keep records, there is no guarantee, without extensive auditing,

that the records will not be kept so as to allocate as little income as possible to the taxing state.

The use of a formula is another method of dealing with the problem of allocation. This method, by the use of one or more factors, determines the percentage of income that should be allocated to the state in question. The formula method is not, from a theoretical standpoint, as equitable a method of apportioning income as separate accounting because it approximates the portion of a businesses income which was derived from sources within the state. The formula method, however, does not have the disadvantages listed above, which are associated with separate accounting.

A state may adopt any formula it wishes, as long as the formula does not discriminate against a particular business. The formula which is most commonly used, however, is the Massachusetts formula. This formula employs three factors: (1) payrolls, (2) tangible property (real and personal), and (3) sales. The first two factors, payrolls and tangible property, work to the benefit of a state which has a large amount of manufacturing and heavy industry. The third factor, sales, works to the advantage of rural states. Iowa, since it is a predominantly rural state, uses a formula which has only one factor, sales, to allocate net income under its corporation income tax.

If South Dakota were to adopt the formula method of allocating income, the formula should allocate as much income as possible to the state. It would be to the advantage of South Dakota to adopt a formula which employs sales as its only factor because this factor works to the

advantage of rural states and, hence, would allocate a larger percentage of income to South Dakota than would payrolls or tangible property.

Thus the recommended allocation formula would be as follows:

$$\frac{\text{Total sales within the state of South Dakota}}{\text{Total sales within and without the state of South Dakota}} \times 100 = \text{Percentage of net income allocated to South Dakota}$$

In conclusion, it is the opinion of the author that South Dakota should, if a corporation income tax is imposed, levy a tax on unincorporated business in South Dakota. The tax should be in the style of that levied by New York; that is, federal income tax definitions of gross and net income should be adopted. The impost should be on the net income of the following types of business; (1) retail, (2) service and amusement, (3) wholesale, (4) manufacturing, and (5) transportation.

Net income should be allocated to South Dakota on the basis of sales in the state to sales everywhere because this would be to the advantage of South Dakota. The rate of the tax should be such that it would impose a burden equal to that which would be imposed if the business were to adopt a corporate structure.

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